No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INC. ET AL.,

Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., ET AL.,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF OF THE GERMAN ASSOCIATION FOR THE PROTECTION OF SHAREHOLDERS, UNION ASSET MANAGEMENT HOLDING AG, AND THE ASSOCIATION FOR AUSTRIAN INVESTMENT COMPANIES AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICI CURIAE[1]

Amici curiae submit this brief to offer the Court a perspective from foreign investors who have chosen to invest in United States markets.

The German Association for the Protection of Shareholders[2] ("DSW") is Germany's oldest and largest association for private investors. Founded in 1947, DSW now brings together the shared interests of more than 32,000 members. Furthermore, DSW is the head office of 7,000 investment clubs in Germany with approximately 5 billion Euros (approximately $6.6 billion) invested capital. DSW is a member of the European Fund and Asset Management Association ("EFAMA"), the representative association for the European investment management industry. With its head office located in Düsseldorf, Germany, DSW works to represent its members' interests in Europe and globally.

Union Asset Management Holding AG ("Union") is based in Frankfurt am Main, Germany and is the holding organization of the Union Investment Group with offices in Germany, Luxembourg, Poland, Italy, and Spain. The Union Investment Group ranks among the three leading German fund managers by market share, with fifty years of experience and almost 2,000 employees. The Group's assets under management are over 159 billion Euros (approximately $209 billion).

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[1] Pursuant to this Court's Rule 37.6, the *amici curiae* state that no counsel for any party authored this brief in whole or in part, and no person or entity other than *amici curiae*, or its counsel, has made a monetary contribution to the preparation of submission of this brief. Pursuant to Rule 37.3, the parties' letters of consent to the filing of this brief have been lodged with this court.

[2] Deutsche Schutzvereinigung für Wertpapierbesitz e.V (DSW).

Founded in 1988, the Association for Austrian Investment Companies[3] ("VÖIG") is the umbrella association of all Austrian capital and real estate investment companies. The association has total capital assets under management totalling 168 billion Euros (approximately $222 billion), with significant investments in United States markets and United States securities. VÖIG is a member of the EFAMA. The head office is seated in Vienna, Austria.

The above *amici* recognize that the oversight of regulators such as the U.S. Securities and Exchange Commission and the New York Attorney General's Office is an important means of ensuring a level playing field for all investors. We strongly believe, however, that investors' right to redress for corporate wrongdoing through individual and class actions under The Securities Act of 1933 ("1933 Act"), 15 U.S.C.A. § 77a-77aa (West, Westlaw through Jan. 2007) and The Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C.A. § 78a-78nn (West, Westlaw through Jan. 2007), is essential to deterring improper conduct and ensuring recoupment of any losses from fraud or other misconduct.

The issue raised in this case—the standard for determining scienter in securities fraud actions—is of great importance to investors. Furthermore, Union has served as lead plaintiff in a securities class action suit. Union and members of DSW and VÖIG have been and might in the future be members of a class of shareholders in a United States securities case and as such have been and may be entitled to proceeds from a settlement.

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[3] Vereinigung Österreichischer Investmentgesellschaften (VÖIG).

INTRODUCTION

This case is about scienter requirements. It is not, as supporting *amici* of Petitioners would have the Court believe, about the efficacy of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737. Nor is the case one in which this Court is called upon to divine congressional intent from an ambiguously worded statute. In passing the PSLRA, Congress created a detailed and complex legislative scheme to accomplish its goals, including a heightened pleading standard for certain elements of securities fraud claims.

The Petitioners' supporting *amici* aggressively urge the Court to adopt an extremist scienter standard that would largely obliterate liability for securities fraud under the PSLRA. Foreign investors' interests would be disserved by such an interpretation because, contrary to Petitioners' *amici* suggestion, the PSLRA and other United States securities laws encourage foreign investment. *Amici* for Respondents and scores of other large European and global institutional investors invest in the United States securities markets. We are well aware of United States securities laws, and we believe that these laws, as currently interpreted and enforced, serve to protect our investments by policing the activities of the market.

We submit this brief in an attempt to correct misinformation provided in the briefs of Petitioners and its supporting *amici*. From our perspective, Petitioners and its *amici* unfairly and unjustly malign a private securities policing system that is not at issue in this case. We do not merely pretend to speak for foreign investors seeking a place to invest—we are in fact foreign investors and the representatives of foreign investors, who have chosen to invest in the United States markets.

ARGUMENT

I. PRIVATE SECURITIES LITIGATION COMPLEMENTS GOVERNMENTAL REGULATION

We do not share the views of Petitioners and their *amici* that the United States private securities policing system is in dire need of revision. Instead, we adopt wholeheartedly the position of *amici* in a recent case before this Court:[4]

> It has long been recognized that private litigation serves as a "necessary supplement" to public enforcement of the securities laws. *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964). According to the congressional testimony of then-Securities and Exchange Commission ("SEC") Chairman Arthur Levitt, "Private actions are crucial to the integrity of our disclosure system because they provide a direct incentive for issuers and other market participants to meet their obligations under the securities laws." *Common Sense Legal Reform Act: Hearing Before the Subcomm. on Telecomm. and Fin. of the House Comm. on Commerce*, 104th Cong. 1 (1995) (prepared statement), *available at* http://www.sec.gov/news/testimony/testarchive/1995/spch025.txt.
>
> Congress enacted the PSLRA, Pub. L. No. 104-67, 109 Stat. 737, codified at 15 U.S.C. § 77z-1 to 78u-5, to remedy perceived abuses in securities litigation. In so doing, Congress

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[4] *See* Brief of N.J. Dep't of the Treasury and Its Div. of Inv. as *Amicus Curiae* in Supp. of Resp'ts in *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005).

emphasized the important continuing role of private plaintiffs in enforcing the nation's securities laws:

> Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely on government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and other properly perform their jobs. This legislation seeks to return the securities litigation system to that high standard.

H.R. Conf. Rep. No. 104-369, at 31-32 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 730-31. In the wake of recent accounting scandals in 2001 and 2002, Congress reiterated the importance of private securities actions when enacting the Sarbanes-Oxley Act of 2002, which, among other reforms, extended the statute of limitations for securities fraud cases. *See* Pub. L. No. 107-204, Title VIII, § 804(a)(b) and (c).

Private enforcement is necessary to [the United States's] current system of regulation because . . . the SEC does not have the resources to police the entire market. *See* United States Gen. Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, GAO-02-302, at 33 (Mar. 5, 2002), *available at* http://www.gao.gov/new.items/ d02302. pdf. . . .

> . . . 2001 through 2003 saw seven of the ten largest bankruptcies in this country's history—including WorldCom, Enron, Global Crossing, and Adelphia—of which at least three have led to criminal prosecutions for accounting fraud. *See* Largest Bankruptcies, 1980-Present. Infoplease (Nov. 16, 2004) *available at* http:// www.infoplease.com/ipa/A0904494.html. . . . [T]he Food and Drug Administration has become so concerned about biotechnology companies overstating the prospects of approval of new products that it has been working with the SEC to set aside its traditional secrecy about pending applications to prevent securities law violations. *See* Ross Kerber, *Regulators Outline Actions to Oversee Drug Firm's Claims: FDA, SEC Would Share Information*, BOSTON GLOBE, Feb. 6, 2004, at C3. . . . [S]ome of the most prominent names on Wall Street have recently been repeatedly entangled by SEC and other investigations involving fraudulent accounting practices,[5] the undue influence of investment banking interests on securities research,[6] and fraudulent initial public offerings allocation practices.[7] In other

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[5] *E.g.*, The SEC Charges Merrill Lynch, Four Merrill Lynch Executives with Aiding and Abetting Enron Accounting Fraud, Accounting and Auditing Enforcement Act Release No. 1742, 79 S.E.C. Docket 2533 (Mar. 16, 2003).

[6] *E.g.*, SEC Sues Merrill Lynch and Henry M. Blodget for Research Analyst Conflicts of Interest: firm and Blodget Settle With SEC, NASD, and NYSE, Release No. 18115, 80 S.E.C. Docket 319 (Apr. 28, 2003).

[7] *E.g.*, *SEC v. Credit Suisse First Boston Corp.*, [2001-2002 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91, 695 at 98, 123 (D.D.C. Jan. 29, 2002).

> words, *amici* overlook the most obvious explanation for any increases in litigation during the past few years: an increase in the occurrence of securities fraud.

Br. of N.J. Dep't of the Treasury, *supra* n.5, at 2-5.

II. SECURITIES LAWS DO NOT DISCOURAGE FOREIGN INVESTORS FROM INVESTING OR FOREIGN COMPANIES FROM LISTING ON U.S. MARKETS

Contrary to the arguments of Petitioners and supporting *amici*, private enforcement of United States securities laws encourages foreign investors to invest in and foreign companies to list on U.S. markets. *Amici* for Petitioners suggest that the United States capital market is becoming less competitive—losing its position relative to other capital markets—and they blame the current state of private securities-law enforcement mechanisms for this decline in competitiveness.

How such argument is relevant to the matter before the Court is unclear, but we, as investment associations and fund managers based abroad, feel compelled to respond to these arguments. *Amici* for Petitioners make two arguments:

> (1) that the private enforcement system discourages foreign companies from listing on U.S. markets[8] or encourages them to prematurely withdraw their listings;[9] and

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[8] Br. of Pet'rs 29 n.14 (Feb. 9, 2007); Br. of the Security Industrial & Financial Markets and Chamber of Commerce of the United States of America 12 (Feb. 8, 2007) ("Br. SIFM & COC").

[9] Br. for Pixelplus Co., Ltd. and Quest Software, Inc. ("Br. Pixelplus & Quest") at n.6 and accompanying text.

(2) that the private enforcement system has "driven away potential investors."[10]

In response to these assertions, we submit the following.

A. The State of the U.S. Capital Market Is Strong—Data on Global IPOs Is Misconstrued and Misrepresented

Amici for Petitioners argue that U.S. capital markets are losing competitiveness in the global market and blame this decline on class-action private enforcement mechanisms for securities laws. In support of their arguments, *amici* point to data that would suggest U.S. capital markets have collapsed in the past five years as its share of initial public offerings has declined dramatically.[11] A closer look at the data shows that the U.S. capital market in 2006 improved its position over 2005 and was just a few percentage points off of its success rate in 2000. Maria Pinelli & Joseph A. Muscat, *Global Capital Market Trends*, (Ernst & Young LLP, White Paper, Jan. 2007) *available at* http://www.ey.com/Global/download.nsf/US/Global_Capital_Market_Trends/$file/GlobalCapitalMarketTrendsWhitePaper.pdf.

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[10] Br. of New England Legal Foundation 17 (Feb. 9, 2007) ("Br. NELF"); Br. SIFM & COC 10-12.

[11] Br. SIFM & COC 10-11. *Amici* bleakly describe the U.S. capital market as follows:

> The United States' share of [IPOs] issued by foreign companies declined from 50 percent in 2000 to only 5 percent in 2005. In 2005, 24 of the 25 largest IPOs worldwide were issued in markets outside the United States, with 9 of the 10 largest IPOs issued during the first 9 months of 2006 taking place in foreign markets.

Id. at 10-11.

A more thorough examination of the IPO data issued last month by Ernst & Young reveals that U.S. markets are "highly successful" at attracting what it terms "at play" IPOs—IPOs that are not so predisposed to list domestically or regionally that the companies would at least consider listing in U.S. markets. The study revealed that the U.S. market's success rate for at-play IPOs in 2006 was 65%, representing an improvement over 2005 (58%) and comparable to the 73.1% in-play-IPO success rate in 2000, two years prior to the enactment of Sarbanes-Oxley. Ernst & Young, *Global Capital*, *supra*, at 3. The report explains that companies tend to choose to list on domestic exchanges when possible and that many markets have recently developed sufficient infrastructure, investors, and liquidity to handle more of its IPOs. *Id.* at 2.

The report also explains how critics of U.S. securities laws have overstated the significance of recent IPO-listing data in decrying the U.S. market's decreasing competitiveness: by failing to mention that 90% of companies chose to list domestically in the first half of 2006 (in line with recent historical averages); by omitting the fact that the five largest IPOs in 2005 were privatizations of French and Chinese state-owned entities; and by neglecting to discuss the relative small size and significance of most IPOs on London's Alternative Investment Market ("AIM") and how its non-UK companies' smaller market capitalization and deal size generally would have been insufficient to attract attention from U.S. analysts. *Id.* at 3; *see also* Charles D. Niemeier, Board Member, Public Co. Acctg. Oversight Bd., *American Competitiveness in International Capital Markets*¶¶ 32, 33, Background Paper for *The Atlantic*'s Ideas Tour Commemorating the Magazine's 150th Anniversary, Washington, D.C., (Sept. 30, 2006) ("Niemeier") ("Notwithstanding the significant valuation premium in the U.S., there are considerable political, cultural, and other

influences on such companies to list locally when their markets offer sufficient liquidity."), *available at* http://www.pcaobus.org/News_and_Events/Events/2006/Speech/09-30_Niemeier.aspx. In commenting on the size of most IPOs on the AIM, executive vice president of NYSE Noreen Culhane recently stated that "[m]any of the companies listed on the AIM today wouldn't come close to meeting NYSE listing standard." Greg Ip, Kara Scannell & Deborah Soloman, *In Call to Deregulate Business, a Global Twist*, WALL ST. J., Jan. 25, 2007; *see* Niemeier, *supra*, ¶ 33 (noting that as of March 2006, only 29 of AIM's 2,220 listed companies were based in the U.S., seven of which have a dual listing or otherwise trade on a U.S. market, and concluding that "[i]t's questionable whether the remaining 22 small companies could have met the threshold listing requirements in the U.S.").

B. Listing on U.S. Markets Decreases Capital Costs and Increases Value, Both of Which Are Products of the U.S. Securities Law Enforcement and Its Effect on Investor Confidence

Companies choosing to list on U.S. markets enjoy higher value for their shares (a so-called "listing premium") and lower capital costs. *See, e.g.*, Craig Doidge, G. Andrew Karolyi & Rene M. Stulz, *Why Are Foreign Firms Listed in the U.S. Worth More?* 33 (Revised, Jan. 2003) ("Doidge, Karolyi & Stulz") *available at* http://jfe.rochester.edu/02367.pdf; Rene M. Stulz, *Corporate Governance and Financial Globalization*, National Bureau of Econ. Reseach Reporter: Research Summary, Fall 2005, ("Stulz") *available at http://www.nber.org/reporter/fall05/stulz.html*; *Foreign Firms Cross-Listed in U.S. Valued Higher*, THE EXCHANGE (NYSE Newsletter, Vol. 12, No. 10), Oct. 2005 *available at* http://www.nyse.com/about/publication / 1131450075226.html. Capital-cost savings and listing premiums are significant inducements for companies to list

on U.S. markets. Doidge, Karolyi & Stulz, *supra*, at 33; Stulz, *supra*, ¶ 10; Niemeier, *supra*, ¶ 10.

The listing premium and lower capital costs offered by the U.S. markets are directly tied to the legal consequences of listing on the U.S. market. Luzi Hail & Christian Leuz, *Cost of Capital Effects and Changes in Growth Expectations around U.S. Cross-Listings* 7 (Working Paper, Oct. 2006) ("Hail & Leuz") ("U.S. disclosure requirements, exposure to SEC enforcement, and *the threat of shareholder litigation* make it harder and more costly for controlling owners and managers to extract private control benefits from outside investors.") (emphasis added) *available at* http://fic.wharton.upenn.edu/fic/papers/06/0619.pdf. Several recent studies have added further support for this position. *Id.* Investor protections in the U.S., with their panoply of enforcement mechanisms—including private enforcement through shareholder class-actions—create the inducements for companies to list in the U.S. markets. *Id.*; Niemeier, *supra*, ¶¶ 10, 19; Stulz, *supra*, ¶ 5.

As NYSE Executive Vice President Noreen Culhane explains, "Global investors feel a new-found confidence when companies are willing to accept U.S. laws and regulations, and they value those companies more." *Foreign Firms*, THE EXCHANGE ¶ 4. "It's safe to say," she continues, "that good corporate governance pays dividends." *Id.* ¶ 13.

Professor Rene Stulz understands how enforcement of securities laws is critical to U.S. markets attracting listings:

> The institutions of the country in which a firm is located affect how investors receive a return from investing in the firm. Perhaps most importantly, a country's laws specify the rights that investors

> have, and the enforcement of the laws determines the extent to which these rights are meaningful.

Stulz, *supra*, ¶ 5. Massachusetts Institute of Technology Professor Simon Johnson similarly concludes in his recent examination of the effect of law on economic outcome: "Law definitely matters," and "[c]ountries with more investor protection have better-developed financial markets and more growth." Simon Johnson, *Coase and the Reform of the Securities Markets*, BUILDING AN INFRASTRUCTURE FOR FIN. STABILITY 200 (Federal Reserve Bank of Boston, Conference Series 44), June 2000 *available* at http://www.bos.frb.org/economic/conf/conf44/.

Professor Andrew Karolyi likewise appreciates the situation: "[g]lobal investors view firms from countries with poor shareholder protection with an element of distrust—[a] U.S. listing is a way in which firms can ease this distrust." *Foreign Firms*, THE EXCHANGE, *supra*, ¶ 11. Therefore, contrary to the suggestion of Petitioners' *amici*, vigorous enforcement of securities laws encourages foreign investment in U.S. stocks. This concept is not mere theory—current data supports substantial and increasing foreign holdings of U.S. securities. *U.S. Net International Investment Position at Yearend 2005*, BEA NEWS RELEASE (U.S. Dep't of Commerce, Bureau of Econ. Analysis New Release), June 29, 2006.

C. Costs of Enforcement are Worth the Benefits to U.S. Markets, Listing Companies, and Investors

Available evidence suggests that costs of compliance with and enforcement of regulations are worth the benefits, which are increasing. Niemeier, *supra*, ¶ 30 (stating that "there is no evidence that the cost of complying with U.S. regulation, including after enactment of the Sarbanes-Oxley Act, have cut into cross-listing premium" and concluding

that "to the contrary, it has increased since 2002, when it dipped to its lowest point since 1997"). Charles D. Niemeier, Board Member of Public Company Accounting Oversight Board, correctly weighs the costs and benefits in a September 2006 paper:

> The concern on policy makers' minds everywhere has been whether the costs of regulation and enforcement in the United States—in particular, the cost of complying with new U.S. requirements relating to internal control over financial reporting—outweigh the benefits of using U.S. markets to obtain capital. To my mind, the answer is a resounding 'NO!' for many reasons, including that the U.S.'s low cost of capital reflects the effectiveness of our securities regulations.

Id. ¶ 27. He continues, "[a]vailable evidence indicates that the savings in cost of capital that companies listed on the U.S. markets enjoy is several orders of magnitude greater [than costs associated with new internal control reporting requirements]." *Id.* ¶ 32.

Moreover, Sarbanes-Oxley should also reduce the costs of enforcement, notes Niemeier, as its internal control provisions focus management and auditors on "identifying problems in a company's internal control before those problems result in material misstatements in financial reports," and "[i]f internal control weaknesses are discovered early enough, companies should have time to address the risk before a material misstatement actually occurs—that is, before investors receive and act on materially wrong information." *Id.* ¶ 39-40.

Niemeier concludes as follows:

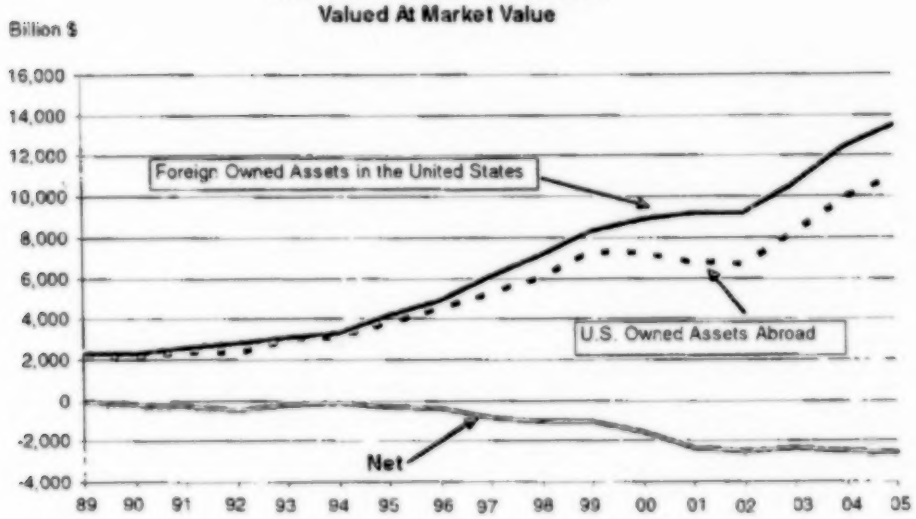
> For all these reasons, claims that the cost of securities regulation in the United States—and in particular improved investor protections adopted in and since the Sarbanes-Oxley Act—has damaged the competitiveness of U.S. companies and markets are to my mind overstated. Indeed, the U.S. financial reporting and disclosure system has strengthened U.S. markets' resilience for the long-term and contributes significantly to the competitive edge the companies that list in U.S. markets enjoy due to favorable long-term funding.

Id. ¶ 41. We concur.

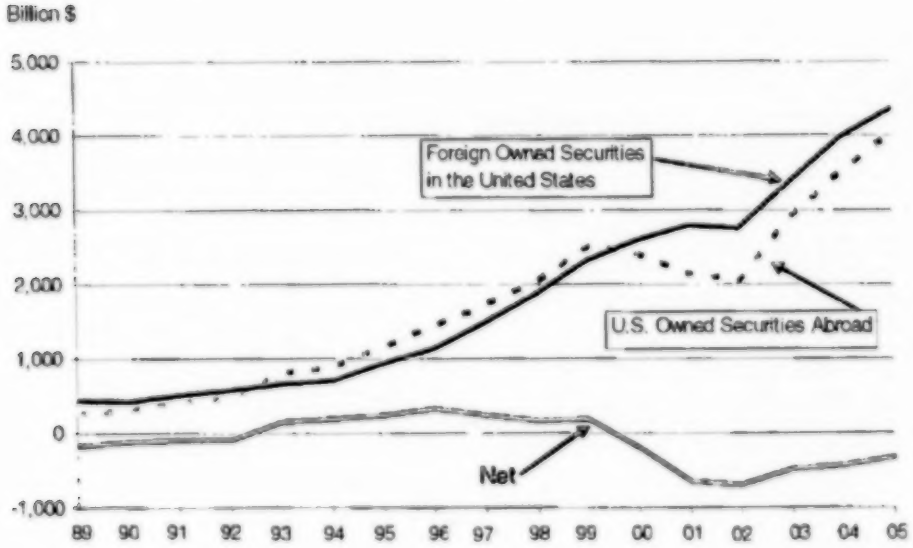
The benefits of maintaining high quality enforcement and disclosure standards are obvious: unmatched public and foreign-investor participation in the U.S. markets and record levels of foreign investment. Foreign investors appreciate the fact that, in Mr. Niemeier's words, "[i]n no other country does the general public participate in business growth opportunities to the extent that the American population does." *Id.* ¶ 6 (explaining that "half of all American households, and one in three individuals, own stocks directly or through mutual funds, up from about one-fifth in 1983"). Reassured by disclosure and enforcement standards and also the high level of U.S. public's participation in the markets, foreign investors continue purchasing U.S.-listed stocks at record levels. Elena L. Nguyen, *The International Investment Position of the United States at Yearend 2005* 9, 14-15 (Dep't. of Commerce, Bureau of Econ. Analysis, July 2006), *available at* http://www.bea.gov/scb/pdf/2006/07July/0706_IIP.pdf; *U.S. Net*, BEA NEWS RELEASE, *supra*. The foreign investment trend is demonstrated by the following graphs from the Department of Commerce, Bureau of Economic Analysis:

Net International Investment Position of the United States at Yearend. 1989 - 2005

With Direct Investment Positions Valued At Market Value



Net International Investment Position of U.S. Market Value of Corporate Securities & Bonds 1989-2005



Sources: U.S. Dep't of Commerce, Bureau of Econ. Analysis; first graph, *U.S. Net International Investment Position at Yearend 2005*, BEA NEWS RELEASE, *supra*, 4; second graph, data provided in spreadsheet on BEA website *available at* link "Yearend positions, 1976-2005" *at* http://www.bea.gov/international/index.htm.

The data show, contrary to the assertion by *amici* for Petitioners that lawsuits have driven away investors, foreign investors, in particular, believe the benefits of the existing disclosure and enforcement system are well worth its costs.

D. Fraud is Increasing Abroad, and Global Markets Are Adopting U.S. Securities Laws

Amici for Petitioners also argue that U.S. markets are losing ground to London and other international business centers and that certain businesses prefer non-U.S. legal environments. However, according to a British accounting firm, securities fraud is rampant in the United Kingdom. "British market watchers believe that shrewd charlatans, whose financial tricks are well known to U.S. authorities, are having a field day in the laid-back London scene." Paul Tharp, *Brits Get Bit—Lax British Marts Attract Fraud Along with U.S. Biz*, N.Y. Post, Jan. 8, 2007, ¶ 1. The study says that rising financial crimes cost British businesses more than $2.7 billion and that fraud claims were up 40% over 2005. *Id.*

Other commentators have issued ominous warnings about the developing capital markets. "At some point, the lack of scrutiny of corporate governance that U.S. securities law now demands is going to rebound with a vengeance," and "markets from Hong Kong to London may end up wishing they had such a law as [Sarbanes-Oxley] and the regulatory agencies that go with it." John Berthelsen, *Heading for Trouble: Asia's Unruly Stock Markets*, Asia Sentinel, Aug. 7, 2006, *available at* http://www.asiasentinel.com/index.php?option=com_content&task=view&id=79&Itemid=32.

As countries recognize the price they pay for lax standards, they are increasingly adopting U.S.-modeled securities regulations:

> Yet even as the U.S. debates whether it has gone too far, other countries are tightening their rules. The EU, Canada, Mexico, Australia, Hong Kong, Brazil, the U.K. and Germany have to varying degrees beefed up standards for audit committees. This means many companies won't escape tighter regulation by avoiding the U.S.

Ip, Scannell & Soloman, *In Call*, *supra*; *see also*, Johnson, *Coase*, *supra*, 201.

For these reasons, we submit that *amici* for Petitioners have presented inaccurate information to the Court.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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